Annual Report 1974

Canadian Merrill Ltd.

Canadian Merrill Ltd.

Incorporated Under the Laws of the Province of Quebec

DIRECTORS

MATTHEW M. BALDWIN,
Edmonton, Alberta
Executive Vice-President of the Company
President of Baldwin & Knoll Limited

KENNETH S. DALTON,
Toronto, Ontario
Vice-President and Treasurer of Hudson Bay Mining and Smelting Co., Limited

JEAN DEBRAY,
Montreal, Quebec
Vice-President of Hudson Bay Mining and Smelting Co., Limited

ADRIAN M. DOULL,
Toronto, Ontario
Vice-President of Anglo American Corporation of Canada Limited

V. LYLE HAWKES,
Edmonton, Alberta
First Vice-President of the Company
President of L & M Oilfield Equipment Ltd.

RANDOLPH P. MILLS,
Montreal, Quebec
Honorary Chairman of the Company

HUBERT J. MOCKLER,
Toronto, Ontario
Chairman of the Board of the Company

HORACE REKUNYK,
Calgary, Alberta
President and Chief Executive Officer of the Company

OFFICERS & EXECUTIVES

RANDOLPH P. MILLS
Honorary Chairman of the Board

HUBERT J. MOCKLER
Chairman of the Board

HORACE REKUNYK
President and Chief Executive Officer

MATTHEW M. BALDWIN
Executive Vice-President

V. LYLE HAWKES
First Vice-President

CHARLES W. TEMPLETON
President of Provident Resources Ltd.

G. BARRY PADLEY, C.A.
Vice-President, Finance and Secretary

EDWARD W. WATT
Mine Manager

ANNUAL GENERAL MEETING

The annual meeting of the shareholders of Canadian Merrill Ltd. will be held in the Windsor Hotel, Montreal, Canada, on Wednesday, the 30th day of October, 1974 at 11:00 A.M. local time.

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The 23rd Annual Report to June 30, 1974

Comparative Highlights

Financial (in dollars)	1974	1973	Increase Per Cent
Revenue by Source:			
Oil and gas, mining	$ 2,966,000	$ 1,735,000	70.9
Well servicing	4,840,000	3,697,000	30.9
Rental and sales of equipment	2,970,000	2,989,000	—
Interest and other income	190,000	80,000	—
	10,966,000	8,501,000	29.0
Deduct: Inter-company revenues	703,000	503,000	39.8
Gross Revenue	10,263,000	7,998,000	28.3
Cash Flow from operations	2,203,000	1,657,000	33.0
Per share	1.09	.82	
Income before extraordinary items	650,000	471,000	38.0
Per share	.32	.24	
Net income for the year	388,000	502,000	(22.7)
Per share	.19	.25	
Capital expenditures	2,304,000	4,614,000	(50.0)
Working capital	1,134,000	(1,624,000)	
Shareholders equity	7,280,000	6,892,000	5.5
Per share	3.61	3.42	
Total assets	19,583,000	16,681,000	17.4
Weighted average of shares outstanding during the period	2,013,920	2,013,586	
Operating			
Oil Production, net before royalties			
Total — barrels	204,695	166,010	23.3
Daily average — barrels	561	455	
Natural gas production, net before royalties			
Total — million cubic feet	5,482	3,963	38.3
Daily average — million cubic feet	15	11	
Number of net productive wells			
Gas	63.1	59.9	5.3
Oil	51.8	51.4	—
Acreage holdings			
Gross	3,232,219	3,218,692	—
Net	604,747	600,027	—
Number of service rigs (including affiliates)	41	38	7.9

Report to the Shareholders

The past year has seen the completion of a three year transitional period in Canadian Merrill's history. During this period, the Company has redirected its activities into the oil and gas industry, primarily in Western Canada but with substantial international interests as well. This change in emphasis has resulted in the Company's major operations now being concentrated in the oil and gas production, well servicing and sales and rental divisions operating in Western Canada. Future expansion will continue to be directed into these divisions together with the development of the international interests. Merrill's executive offices have been consolidated with its oil and gas operating office in Calgary to further improve the operating and administrative efficiency of the Company.

Merrill continued to achieve significant increases in production and revenues for the fiscal year 1974. Gross revenue from all operations increased by 28% to $10,263,000. Cash flow from operations increased by 33% to $2,203,000 or $1.09 per share. Income before extraordinary items was $650,000 ($0.32 per share) as compared with $471,000 ($0.24 per share) for the prior period, an increase of 38%. After the provision of a $300,000 reduction with respect to the carrying value of our investment in Magnetics International Ltd., net income was $388,000 ($0.19 per share).

During 1974, Merrill entered into gas purchase contracts that provide for the sale of the Company's undedicated gas reserves. The contracts also result in an increase in the selling price of gas from 26¢ per thousand cubic feet (Mcf) to 60¢ per Mcf on November 1, 1974, covering approximately 21% of the Company's current production. The selling price of gas on the remaining 79% of current production will increase from 26¢ to 62¢ on November 1, 1975.

Approximately 60% of the undedicated gas reserves have been contracted to Greater Winnipeg Gas Company and are scheduled to go on production in November, 1974 at a price of 60¢ per Mcf. The remaining undedicated gas reserves located in various areas have been contracted to TransCanada PipeLines Limited at a price of 60¢ per Mcf with one field going on production in September, 1974. It is planned that all properties will be on production by the fall of 1975. As a result, substantially all of the Company's gas reserves developed to June 30, 1974 will be on stream by late 1975 at the current new gas prices, subject to annual re-negotiation.

The increased gas prices effective in November, 1974 and new gas reserves going on stream will add substantially to the Company's revenues. It should be noted, however, that the increased prices have been accompanied by increased royalties and taxation by the Provincial and Federal Governments and a far greater involvement by these governments in the

affairs of the industry. This has resulted in material reductions in the Company's shares of product price increases at a time when the costs of finding and producing oil and gas are increasing dramatically.

We are confident that the two levels of government and industry will resolve the conflicts so that exploration may be continued on a basis competitive with other countries.

It was the Company's early recognition of the increasing taxation and involvement by the governments in Canada that caused it to direct a portion of its exploration efforts into highly potential international areas. In its exploratory activities in Peru, the Company holds a 12½% interest in a production sharing contract with Petroperu, the Peruvian national oil company, covering the 2,500,000 acre Block 4 in the Oriente area of northern Peru. A 1,200 mile seismic program scheduled for completion in July, 1975 is currently in progress on the property. To date, 265 miles of this program have been completed. Interpretation of the results indicate several significant structures and upon conclusion of the seismic program the first drill site will be selected with drilling scheduled to commence in the fall of 1975.

At present, the Company's future activities in Canada will generally be restricted to existing contractual undertakings, largely involving the construction of gathering and processing facilities for developed gas reserves. The Company's exploration activities will be limited to drilling fund partnerships that allow it to participate on a leverage basis resulting in exploration economics which offset to some degree the restrictive economic effect of current or proposed legislation. It is anticipated that we will manage a private drilling fund of approximately $1,500,000, with approximately 75% of these funds to be spent in the United States. The direction of drilling fund money to United States prospects is influenced by the fact that the prices received by the producer in the United States is more related to world prices which recognize the dramatic increase in the cost of finding and developing oil and gas. In addition, we will participate with a second drilling fund partnership representing a $3,000,000 exploration program in the Foothills area of Alberta.

The Company's well service division increased its fleet by three service rigs to a total of 41 rigs. In the rental and sales division, the Company increased its rental inventory by 16%. The total service operations have shown a 17% increase in revenues. These divisions are not adversely affected by the current reduction in exploratory drilling, although present interim reductions in Canadian oil requirements due to offshore supplies from the Far East may cause a short-term decline in rig activity. However, the long-term Canadian demand for domestic oil supplies will require maximum production rates from existing wells resulting in more frequent servicing which should directly benefit the Company. We therefore expect continued expansion in the well servicing, rental and sales divisions.

The mining division attained profits greater than last year from the Icon Sullivan Joint Venture as the result of improved copper prices. It is anticipated that ore reserves from the Icon Sullivan mine will be exhausted by December, 1974. Negotiations are currently in progress for the sale of Merrill's milling and related facilities used in the Icon operation. The Company is also negotiating with other companies to conduct exploration programs on the remaining of Merrill's mining assets, the Perch River and Lake Antoinette claims.

During the Company's three year transition into the oil and gas industry, it has invested approximately $10,000,000 into capital assets. This investment has been financed by cash flow from operations, working capital and short-term bank borrowing. The resulting net decrease in working capital necessitated a refinancing of a portion of the Company's debt with a longer term to provide the necessary net cash flow for future capital requirements. In this regard, the Company successfully completed a financing on February 28, 1974, resulting in the sale of a

$4,000,000, 15-year, 6½% secured convertible income debenture to Hudson Bay Mining & Smelting Co., Limited. The debenture is convertible into common stock of the Company at a rate of $6.00 of debenture for one share of common stock during the first five years and $7.00 of debenture for one share during the next five years. The debenture is repayable at a rate of $400,000 per annum commencing in the sixth year.

Concurrent with this debenture financing, Hudson Bay also acquired a 10% equity interest in the Company through the purchase of shares from certain shareholders and has subsequently acquired additional shares to increase its interest to 23%. We believe that our relationship with Hudson Bay will be of significant benefit to the Company as it will give us a stronger base for future developments in Canada and as the Company expands its international operations.

It is with deep regret that we report the death of Mr. C. A. Geoffrion, Q.C. who had served as a Director of the Company since its inception in 1950. During the past year, Messrs. N. E. Corning and R. L. Segsworth retired from the Board of Directors. The Board expresses its appreciation to the retiring Directors for their contribution to Canadian Merrill during their association with the Company. Messrs. K. S. Dalton, J. DeBray and A. M. Doull, all nominees of Hudson Bay Mining & Smelting Co., Limited, were appointed in their place.

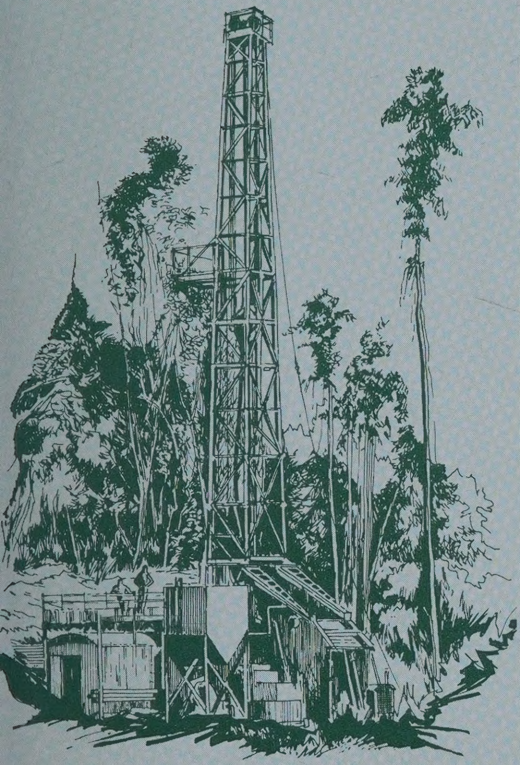
On behalf of the Board of Directors, I wish to thank the employees of the Company and its operating divisions for the capable manner in which they carried out their varied responsibilities last year. The financial results presented in this report reflect the cumulative efforts of our staff.

Respectfully submitted on behalf of the Board of Directors.

H. ReKunyk,
President and Chief Executive Officer

September 30, 1974
Calgary, Alberta

Oil and Gas Operations



The Company on its own behalf and through its wholly-owned subsidiary, Provident Resources Ltd., continued an active drilling program during the fiscal year 1974. The Company participated in drilling 34 wells resulting in 8 gas wells, 1 oil well and 25 dry holes. All of the successful wells and 24 of the dry holes were drilled by the Provident Oil and Gas Drilling Fund Programs under which the Company does not participate in dry hole costs.

The Company's drilling and development expenditures for its own account and on behalf of the participants in the 1973 Drilling Fund Program totalled approximately $3,500,000. Provident provided the tangible well costs for the successful 1973 Drilling Fund Program wells and earned a 40% working interest in the reserves developed by this Program.

Merrill on its own account, and through Provident Resources, holds interests in 147,104 gross acres of productive lands equivalent to 72,093 net acres, including 125 gross and 63.1 net gas wells and 242 gross and 51.8 net oil wells. These wells are located in oil and gas fields in the Canadian provinces of Alberta, British Columbia and Saskatchewan and the states of Montana, Wyoming, Texas, Louisiana and West Virginia in the United States.

The Company's share of production before royalties averaged 561 barrels of oil per day and 15 million cubic feet of natural gas per day during the year ended June 30, 1974. This is equivalent to an average of 1,500 barrels of oil per day after converting the gas production to equivalent barrels of oil compared with 1,140 barrels per day in the fiscal year 1973. Production from the Company's properties in the United States now accounts for approximately 20% of the Company's oil and gas revenues.

Merrill holds substantial gas reserves in the Edwand-Hanmore area scheduled to go on production in November, 1974 at a price of 60¢ per thousand cubic feet (Mcf). The Company's gas reserves at Sullivan Lake were placed on production at the 60¢ price in September, 1974. In addition, currently producing gas wells in the Plain Lake and Warwick fields will be subject to a price increase to 60¢ per Mcf effective November 1, 1974 and the gas producing properties in the Birch Lake, Stanmore and Willingdon fields will increase to 62¢ per Mcf on November 1, 1975.

Under the terms of a voluntary agreement between the Canadian Government and the oil industry, the price of Western Canadian crude oil was frozen at approximately $4.00 per barrel until April 1, 1974 when it was allowed to increase to $6.50 per barrel. This new price will remain in effect until October 1, 1975 following which we would anticipate some further

increases to the producer based on world prices at that time.

The increase of $2.50 per barrel to $6.50 per barrel is subject to an Alberta provincial royalty of 65%. In Saskatchewan, all of the increase is payable to the government based on a revised mineral tax.

By contrast, the Company's production from the United States is currently being sold at prices up to $10.76 per barrel and is subject to total royalty and taxes of approximately 20%.

Merrill's activities in the past year included the following operations:

ALBERTA

Edwand-Hanmore

The Company continued its drilling activities in this area by completing 4 new gas wells west of its previously developed properties. These wells were drilled as part of the 1973 Drilling Fund Program. Merrill now holds various interests in 26 gas wells in this area through its participation with the 1971, 1972 and 1973 Drilling Fund Programs. The majority of these wells have several potential gas producing zones.

The Company has entered into a gas sales contract for the sale of the Edwand-Hanmore production to Greater Winnipeg Gas Company at a price of 60¢ per Mcf, effective November 1, 1974. This price is subject to annual redetermination. The dehydration-compression plant and the gathering system to tie in 13 wells is currently under construction and is scheduled for completion in November, 1974 at a cost in excess of $1,500,000.

Mons Lake

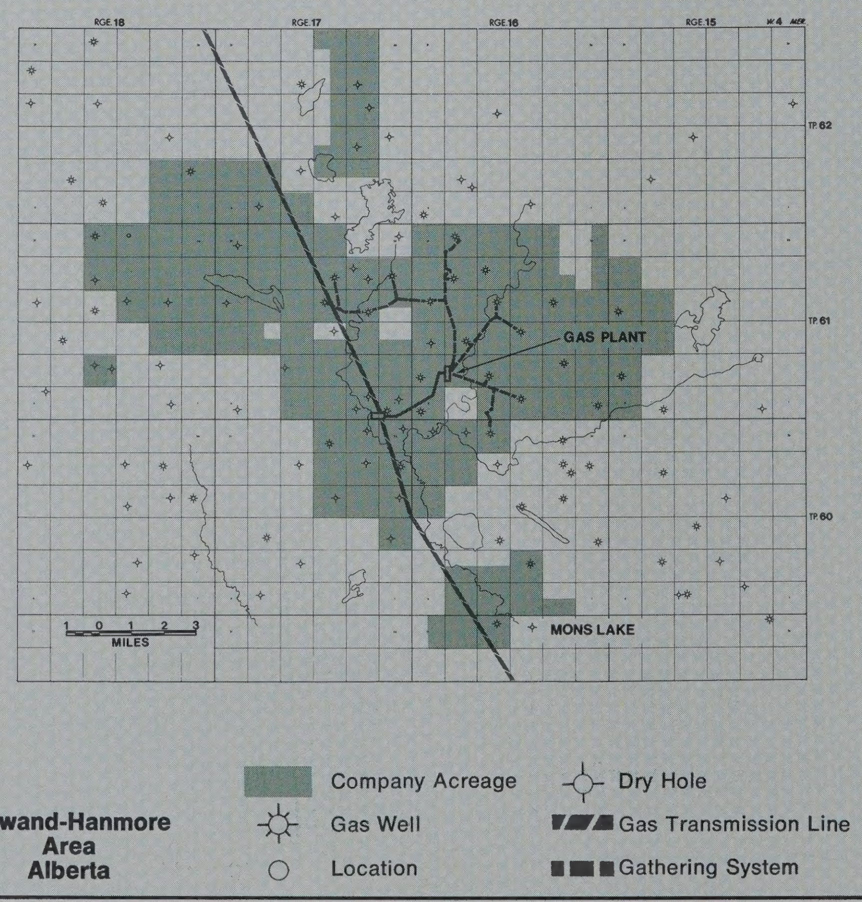
The Company completed two gas wells in the Mons Lake area immediately southeast of its Edwand-Hanmore properties. The wells are located on a 5,140 acre lease block in which the Company holds various interests. Additional drilling will be carried out to define the potential of this area.

Warwick

A dual zone gas well was drilled by the Company in the Warwick area where it holds interests in 17,000 acres of lease. This well will be on production by the end of 1974.

Baxter

The Company drilled three suc-



Edwand-Hanmore Area Alberta

cessful gas wells in this area following June 30, 1974. Two of these wells were completed as dual zone producers. A gas transmission line is located two miles from this 2,720 acre lease block and we anticipate gas sales will commence in 1975.

Cherhill

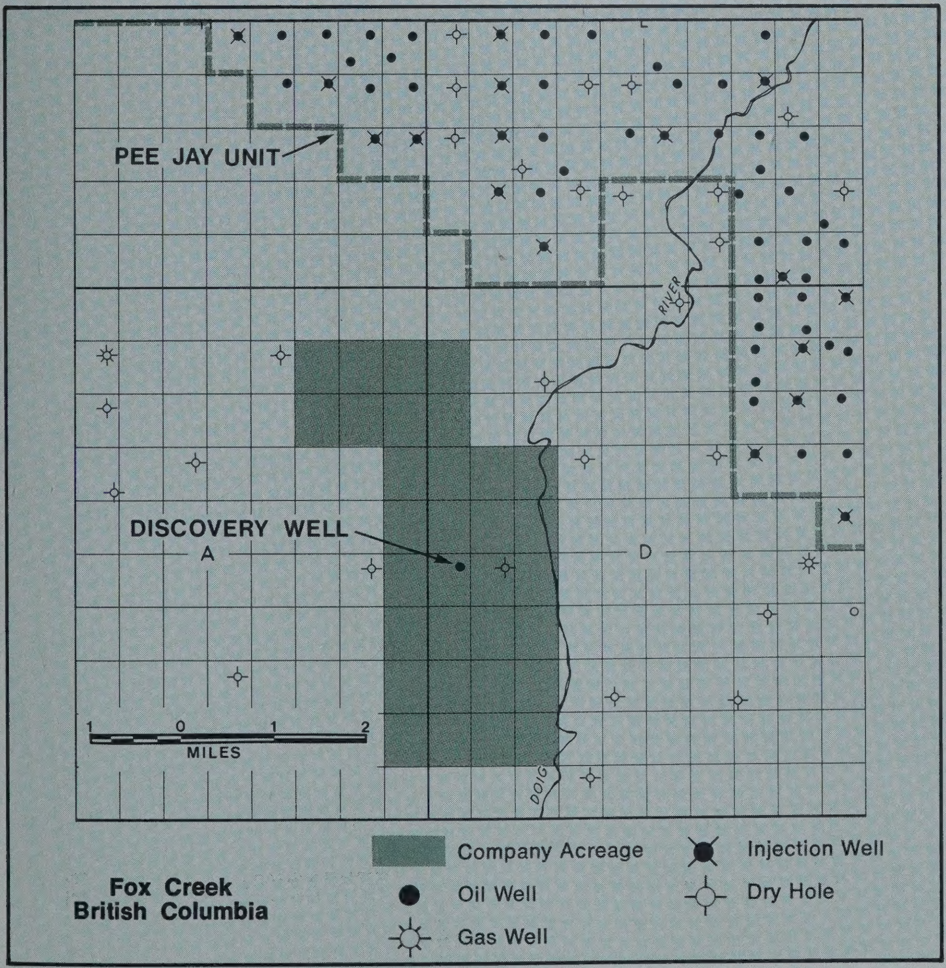
A successful dual zone gas well was drilled on a 640 acre lease in the Cherhill area. The well is being production tested and will commence production in late 1974.

Sullivan Lake

The Company's 7,360 acres of lease and two gas wells in this area have been included in the Sullivan Lake Gas Unit No. 1 in which the Company holds a net 8.3% interest. The unit was placed on production in September, 1974.

Schuler-Medicine Hat

The Company holds a minor interest in 7,360 acres of Milk River gas rights in this area on which 4 wells were drilled last year. A drilling program consisting of 19 additional Milk River wells will begin shortly with gas sales anticipated later this year at a price of 60¢ per Mcf.



BRITISH COLUMBIA

Fox Creek

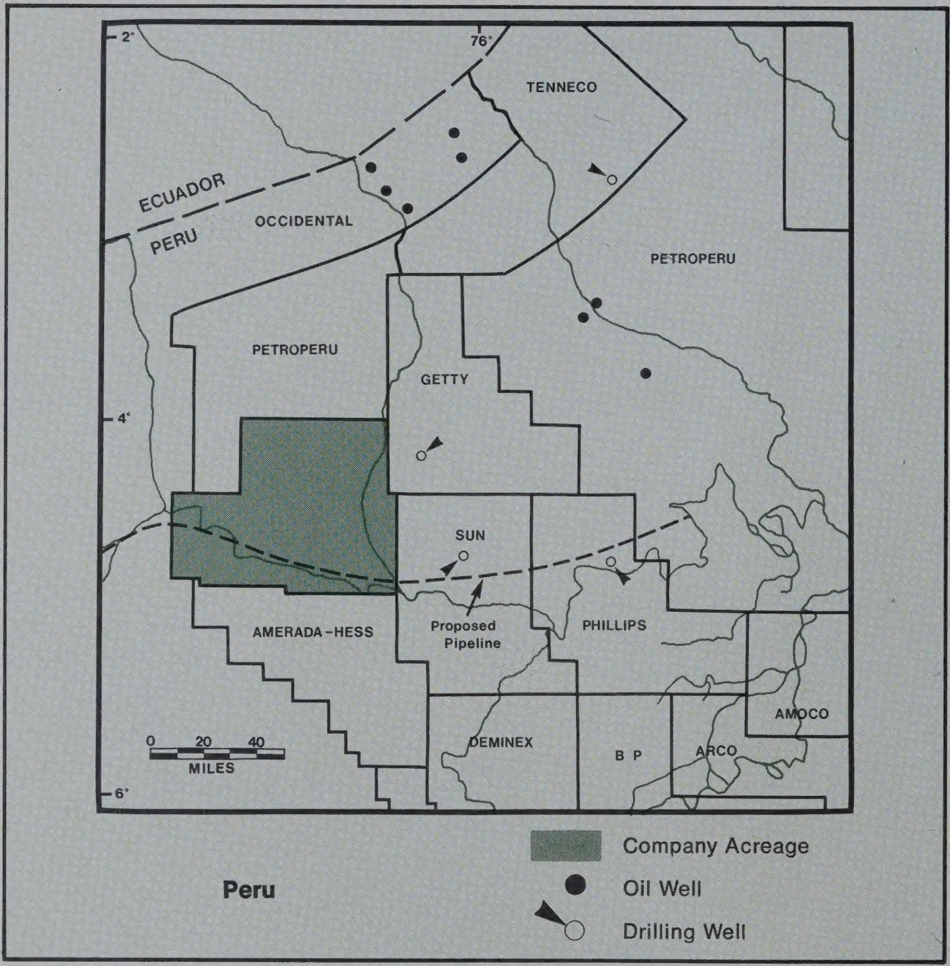
The Company participated in the drilling of an oil discovery in the Fox Creek area in northeast British Columbia. This well is located on a block of leases totalling 5,600 acres, approximately 3½ miles south of the nearest producing oil wells in the PeeJay Unit.

Due to surface conditions, it will not be possible to complete production tests on the well or to begin development drilling until after freeze-up this fall. The Company intends to participate in a drilling program this winter to establish the areal extent of the field.

WYOMING

Bitter Creek Unit

The Company holds a 100% working interest in a 640 acre lease located in Sweetwater County, Wyoming. A very significant deep test well, located ¾ mile from this lease is presently drilling at 20,600 feet. This well, Amoco Prod. 1 Bitter Creek II Unit, is reported to have encountered oil and gas shows in several Cretaceous sands. The well is scheduled to drill to approximately 24,000 feet to test another four potential zones prior to final evaluation of the shows encountered.



PERU

The Company holds a 12½% working interest in Block 4 which is a 2,500,000 acre contract area located in the Upper Amazon Oriente area of northern Peru. Petroperu, the Peruvian national oil company, has granted a number of contracts in the Oriente area and has also retained a large area for its own exploration and development.

A seismic program was started in December, 1973 covering all of the Block 4 acreage. The interpretation of the results to date has indicated several significant structures. Upon conclusion of the seismic program in July, 1975, the first drill site will be selected with drilling scheduled to commence in the fall of 1975.

Exploratory wells are currently being drilled by Getty Oil and Sun Oil at locations 12 miles and 27 miles east of our Block 4 lands.

Petroperu has completed several oil discoveries with proved reserves reported at over 50 million barrels of oil. These wells are located approximately 90 miles northeast of Block 4. Occidental Petroleum, drilling 90 miles north of Block 4, is reported to have developed an estimated 250 million barrels of oil. Production tests of the Occidental wells have indicated initial productive capacity ranging from 3,000 to 9,000 barrels of oil per day per well. Current indications are that exploratory activity will continue to increase in this region through 1975.

Construction of an oil pipeline from the Oriente oil wells is underway and expected to be completed by early 1977. As shown on the accompanying map, this pipeline will be constructed across the southern portion of the Company's acreage.

RESERVES

In past years, Merrill has reported estimated reserves on a net basis after deducting royalties. In view of the continuing changes in the Alberta royalty structure, including the removal of the previous ceiling on royalty rates and the possibility of further revisions, the Company is now reporting its reserves on a gross basis as outlined in the table below. The Company believes that gross reserves provide a more meaningful base for future reporting. The 1973 reserves have been restated for comparison.

The gross reserves, as evaluated by independent consulting engineers and Merrill's staff, represent the Company's interest in proved and probable reserves before deducting royalties payable.

PROVED AND PROBABLE RESERVES	June 30, 1974	June 30, 1973
Natural Gas (billion cubic feet)	185	186
Crude Oil (barrels)	1,754,000	1,900,000

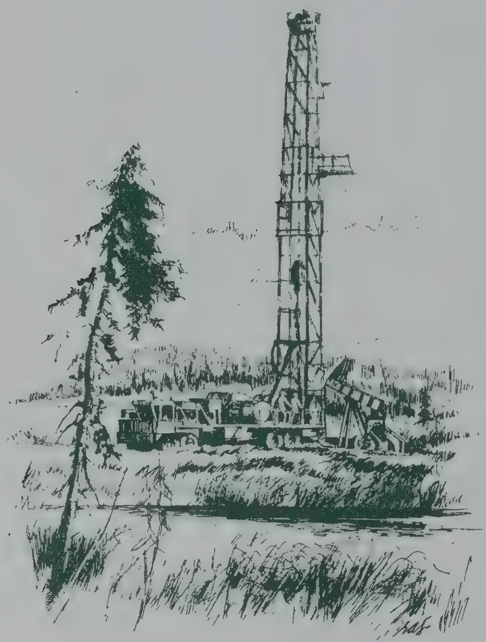
The increase in estimated reserves of natural gas and crude oil during the fiscal year 1974 was offset by production for the year, adjustments resulting from a recalculation based on additional field production data and a re-evaluation of shut-in gas reserves.

ACREAGE HOLDINGS

As at June 30, 1974, the Company and its wholly-owned subsidiaries held 3,232,219 gross acres and 604,747 net acres of producing and undeveloped acreage in the following areas:

	Producing		Undeveloped	
	Gross	Net	Gross	Net
Alberta	114,000	56,414	275,000	160,000
Saskatchewan	480	312	—	—
British Columbia	332	67	11,930	2,700
Arctic Islands	—	—	151,839	25,307
East Coast Offshore	—	—	72,169	12,028
U.S.A.	32,292	15,300	38,177	20,828
Peru	—	—	2,470,000	308,750
U.K. North Sea	—	—	66,000	3,041
Total	147,104	72,093	3,085,115	532,654

Service Operations



During 1974, the well servicing division, Baldwin & Knoll Limited and subsidiary companies, continued to achieve excellent results in all areas. Both revenues and profits showed an increase over the previous year. Expansion moderated somewhat from that experienced in 1973 (six rigs) with the addition of three new rigs and one replacement rig increasing the total fleet to 41 units. Expansion in the forthcoming year is likely to be limited to two rigs with our major emphasis placed on the upgrading of existing equipment and services offered to customers so that we may maintain our share of the market and provide services based on customer demands in specific areas.

The well servicing division is presently faced with labour and equipment shortages that may curtail the division's ability to sustain the rate of growth achieved during the past two years.

Recently, greater interest has been shown in the development of shallow gas and heavy oil production, which will in turn influence the demand for service rigs. At present, the well servicing market is showing a slight decline due to the 150,000 barrel per day cut-back of demand for Western oil to Eastern Canada caused by the resumption of Far East oil imports. In addition, the influence on the net wellhead price to the producer caused by the conflicting taxation demands by the Provincial and Federal Governments has led to uncertainty. Merrill believes these conflicts will be resolved at the conclusion of Federal-Provincial discussions currently in progress. Until then, most oil companies are reluctant to commence any large scale exploration or development programs in Canada. However, the long-term Canadian demand for domestic oil supplies will require more frequent servicing for existing wells which should directly benefit the Company.

Revenues from our rental and sales division, L & M Oilfield Equipment Ltd. remained virtually unchanged from the previous year. However, there was an increase in profit in this division due to the increase of volume in the rental division as the result of equipment additions made in 1973 combined with a higher demand.

A large portion of our rental business is directly related to the well servicing industry and in particular its activity in the Swan Hills, Judy Creek and Edson areas of Alberta. The increased demand for oil production in these areas is expected to continue throughout the forthcoming year and we are anticipating a high rental activity.

Equipment sales for the current year were reduced due to the shortages in equipment from the manufacturer. Due to these shortages, our sales were limited to one service rig compared to a demand for approximately 10 service rig units had they been available. This represents a loss of revenue in excess of $1,000,000. The forecast is that these shortages may continue for at least another two years.

The Company has moved into new facilities in Edmonton, Alberta. These facilities are located on five acres of land and include expanded shop facilities, storage and office space.

Merrill is currently conducting preliminary market surveys of international oil producing areas to ascertain where expansion of our servicing operations may be undertaken.

Mining Operations

The Company's principal mining activity continued to be the contract milling operation conducted on behalf of the Icon Sullivan Joint Venture located in Chibougamau, Quebec. For the fiscal year 1974, 198,000 tons of ore were processed in our mill to yield 10,988,000 pounds of copper. The comparable figures for the 1973 period are 212,000 tons and 12,068,000 pounds respectively. However, the lower output was more than offset by the high average copper prices received during the current year. As a result, revenue from this source was increased by 84% over the 1973 comparative period. Regrettably, the ore reserves at the Icon mine are virtually exhausted and it is now anticipated that the scheduled sequence of withdrawal in effect will be completed by December 1974.

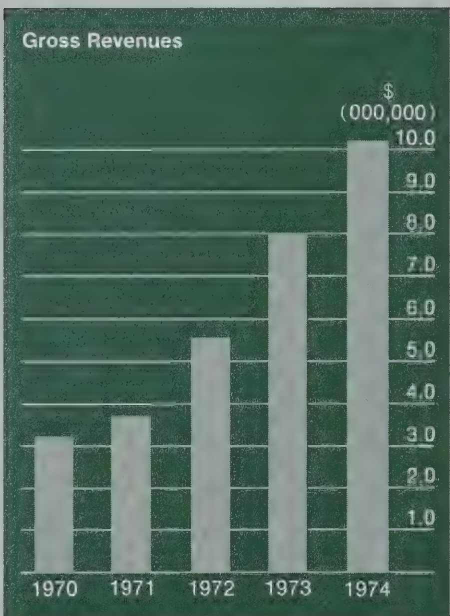
The Company has received several favorable written offers for the purchase of its milling assets located in Chibougamau upon termination of the Icon contract. It is management's intention to dispose of the milling assets and thereby phase out completely from this area of activity.

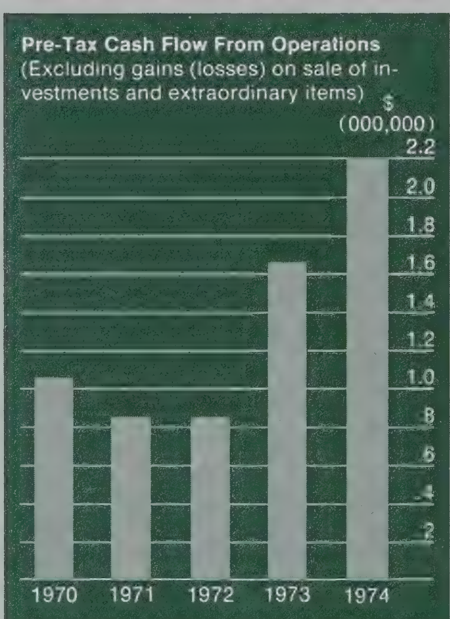
In the mining exploration area, the majority of our efforts were again directed towards the underground development of the Perch River prospect which is located approximately fourteen road miles from the Icon mine. As a result of the work conducted during 1973-1974, the Company has earned a 50% interest in the Perch River claims pursuant to its agreement with Perch River Mines Ltd. To date, work performed on this prospect has failed to establish commercial ore reserves.

While the results from the development decline adit on its property have been limited in terms of our initial expectations, it should be noted, however, that the Perch River prospect includes 138 claims totalling approximately 5,500 acres on which the work to date has explored only a small portion of the total prospect claims. The Company is currently reviewing proposals for the exploration of the balance of the prospect claims.

In addition to Perch River, the Company owns 27 claims in the Lake Antoinette area, located about 3 miles north of the town of Chibougamau, which it intends to have further evaluated under an exploration agreement with another company.

Financial





The accompanying charts present the revenues and pre-tax cash flow from operations (excluding gains (losses) on sale of investments and extraordinary items) of Merrill and its subsidiaries. The information presented for the periods 1970 to 1972 inclusive includes the operations of service subsidiaries that were acquired in December, 1971 and May, 1972 (accounted for as purchases in the consolidated financial statements) as though their revenues and pre-tax cash flows had been part of the Merrill operations for the periods preceding their acquisition dates.

Merrill's gross revenue from all sources for the year ended June 30, 1974 was $10,263,000, an increase of $2,265,000 (28%) over the 1973 corresponding period. Not included in these gross revenues was $703,000 (1973—$503,000) of sales made by our rental and sales division, L & M Oilfield Equipment Ltd., to other operating divisions within the Merrill group. These combined revenues represent record high levels for each of our operating divisions.

Interest charges, in aggregate, increased from $399,000 to $747,000, primarily the result of higher interest rates on bank debt and to a lesser extent, higher average levels of overall debt for 1974 over 1973.

Indirect costs and general and administrative expenses include costs of approximately $125,000 incurred on a Form S-1 Registration Statement filing with the Securities and Exchange Commission, and legal fees associated with litigation concluded during the period under review. These costs are not expected to be of a recurring nature.

Pre-tax cash flow from operations amounted to $2,203,000 ($1.09 per share) as compared to $1,657,000 ($0.82 per share) for 1973, an increase of 33%. Income, before extraordinary items, was $650,000 ($0.32 per share) as compared to $471,000 ($0.24 per share), an increase of 38%.

As of June 30, 1974, management deemed it prudent to provide in the accounts, a provision (reduction) of $300,000 with respect to the carrying value of our investment in the shares of Magnetics International Ltd. As a result, net income for 1974 was reduced by that amount and was $388,000 ($0.19 per share) as compared to $502,000 ($0.25 per share) for 1973.

Capital expenditures totalled $2,304,000 for 1974, a decrease of $2,310,000 from the 1973 level of $4,614,000. The 1974 level of expenditure was incurred relatively equally between our resource operations and our well servicing and rental operations.

During 1974, Merrill issued a 6½% Secured Convertible Income Debenture in the amount of $4,000,000 to Hudson Bay Mining and Smelting Co., Limited. Concurrent with this transaction, Hudson Bay acquired a 10% equity interest in Merrill from certain Management shareholders. The receipt of the $4,000,000 completed the financing of the Company's capital expenditure program of the past three years, which amounted to approximately $10,000,000. At the same time, the Company has obtained a higher total "line of credit" from The Royal Bank of Canada which has placed it in an excellent position to provide funds for new ventures. Capital expenditures of $4,800,000 have been approved by the Board of Directors for the forthcoming fiscal period.

Working capital as of June 30, 1974 was $1,134,000 an increase of $2,758,000 from the June 30, 1973 deficiency of $1,624,000.

Canadian Merrill Ltd.

Consolidated Statement of Operations

(in Canadian dollars)

	Year ended June 30	
	1974	1973
Revenues:		
Sales and other operating revenues	$10,073,000	$ 7,918,000
Interest and other income	190,000	80,000
	10,263,000	7,998,000
Costs and expenses:		
Direct cost of sales and operations	5,574,000	4,792,000
Indirect costs including general and administrative	1,696,000	1,090,000
Interest on long term debt	496,000	353,000
Interest on income debenture	87,000	—
Interest — other	164,000	46,000
Mining exploration	43,000	60,000
	8,060,000	6,341,000
Funds generated from operations before current income taxes	2,203,000	1,657,000
Provision for depreciation, depletion and amortization	(1,048,000)	(740,000)
Amortization of goodwill	(61,000)	(56,000)
Gain on sale of properties and equipment	126,000	107,000
Equity in net incomes of affiliated companies	18,000	21,000
	(965,000)	(668,000)
	1,238,000	989,000
Income taxes (Note 15):		
Current	154,000	75,000
Deferred	428,000	431,000
	582,000	506,000
Minority interest	6,000	12,000
	588,000	518,000
Income before extraordinary items (Note 1)	650,000	471,000
Provision for decline in value of investment in Magnetics International Ltd.	(300,000)	—
Gain (loss) on sale of investments	38,000	(28,000)
Gain on sale of petroleum drilling rig and equipment (net of $56,000 deferred income taxes)	—	59,000
Net income for the year	$ 388,000	$ 502,000
Income per common share (Note 1):		
Before extraordinary items	$ 0.32	$ 0.24
Extraordinary items	(0.13)	0.01
Net income for the year	$ 0.19	$ 0.25

Canadian Merrill Ltd. (Governed by the Quebec Companies Act)

Consolidated Balance Sheet

(in Canadian dollars)

assets	June 30 1974	1973
Current assets:		
Cash and deposit receipts	$ 1,574,000	$ 132,000
Accounts receivable (Note 3)	2,733,000	1,974,000
Inventories (Note 4)	410,000	353,000
Prepaid expenses	68,000	62,000
	4,785,000	2,521,000
Interest bearing advances — drilling fund programs (Note 5)	104,000	16,000
Investments (Note 6):		
Companies for which there is a quoted market value	604,000	1,081,000
Affiliated companies	268,000	269,000
	872,000	1,350,000
Properties and equipment, at cost (Note 7)	16,899,000	15,086,000
Less: Accumulated depreciation and depletion	4,582,000	3,768,000
	12,317,000	11,318,000
Deferred costs (Note 8)	398,000	351,000
Other assets, at cost	57,000	58,000
Goodwill (Note 1), less amortization of $128,000 (1973 — $67,000)	1,050,000	1,067,000
	$19,583,000	$16,681,000

APPROVED ON BEHALF OF THE BOARD:

H. REKUNYK, Director.

M. M. BALDWIN, Director.

liabilities	June 30 1974	1973
Current liabilities:		
Bank demand loans and indebtedness (Note 9)	$ 277,000	$ 1,190,000
Accounts payable and accrued	2,177,000	1,734,000
Current portion of long term debt	1,197,000	1,221,000
	3,651,000	4,145,000
Long term debt (Note 10)	6,827,000	4,149,000
Deferred oil and gas revenue	170,000	266,000
Deferred income taxes (Note 15)	1,637,000	1,209,000
Minority interests	18,000	20,000

shareholders' equity

Capital stock (Note 12):		
Authorized —		
2,000,000 preferred shares of $5 par value		
10,000,000 common shares of no par value		
Issued —		
2,013,920 common shares	6,692,000	6,692,000
Retained earnings (Note 13)	588,000	200,000
	7,280,000	6,892,000
Contingent liabilities and commitments (Note 11)		
	$19,583,000	$16,681,000

Canadian Merrill Ltd.

Consolidated Statement of Changes in Financial Position

(in Canadian dollars)

	Year ended June 30 1974	1973
Working capital was provided by:		
Operations —		
Funds generated from operations before current income taxes	$ 2,203,000	$ 1,657,000
Less: Current income taxes	154,000	75,000
	2,049,000	1,582,000
Extraordinary items —		
Sale of investments	236,000	809,000
Sale of petroleum drilling rig and equipment	—	175,000
	2,285,000	2,566,000
Issue of 6½% secured convertible income debenture	4,000,000	—
New long term debt	336,000	2,538,000
Issue of common shares	—	2,000
Increase in deferred oil and gas revenue	—	23,000
Sale of properties and equipment	448,000	601,000
Decrease in advances to drilling fund programs	—	82,000
Other	—	23,000
	7,069,000	5,835,000
Working capital was used for:		
Additions to properties and equipment	2,304,000	4,614,000
Increase in advances to drilling fund programs	88,000	—
Decrease in deferred oil and gas revenue	96,000	—
Purchase of investments	22,000	8,000
Reduction of long term debt	1,659,000	1,792,000
(Repayments) advances to affiliated companies	(18,000)	27,000
Deferred exploration costs	111,000	228,000
Other	49,000	37,000
	4,311,000	6,706,000
Increase (decrease) in working capital for the year (Note 2)	2,758,000	(871,000)
Working capital (deficiency) beginning of year	(1,624,000)	(753,000)
Working capital (deficiency) end of year	$ 1,134,000	$ (1,624,000)

Notes to Consolidated Financial Statements

at June 30, 1974

1. Summary of significant accounting policies:

Principles of consolidation —

The consolidated financial statements include the accounts of Canadian Merrill Ltd. and its subsidiaries all of which (except for two which are 80% owned) are wholly-owned.

The equity method of accounting for investments in affiliated companies (20% to 50% owned) is followed.

In the case of acquisitions accounted for as purchases, the cost of investment in such subsidiaries in excess of the estimated value of the underlying net tangible assets at dates of acquisition, "Goodwill", is being amortized by charges against operations over a twenty-year period on a straight-line basis.

Inventories —

Inventories held for resale are valued at the lower of average cost and net realizable value. Inventories of supplies are valued at the lower of average cost and replacement cost.

Oil and gas drilling fund programs —

As manager of oil and gas drilling fund programs, a subsidiary company, Provident Resources Ltd., charges each program with allocated direct costs incurred on the program's behalf. Unbilled costs, included in accounts receivable, represent expenditures incurred on behalf of such programs.

Pursuant to the authority granted to it as manager of the programs, Provident finances continuing program activities by bank loans, secured by assignments of title to certain program properties. Advances to programs are considered to be eliminated on allocation of bank loans so obtained as outlined in Note 5.

Investments in companies for which there is a quoted market value —

These investments are carried at the lower of cost or estimated ultimate realizable value.

Properties and equipment — depreciation, depletion and amortization —

Oil and gas properties and equipment —

The companies follow the full cost method of accounting for petroleum and natural gas properties whereby all costs relating to the exploration for and development of oil and gas reserves are capitalized. Such costs include acquisition costs, geological costs, carrying charges of non-producing properties, costs of drilling both productive and non-productive wells and production equipment and gas facilities. Depletion and depreciation are provided for by the unit of production method based on the total estimated proven recoverable reserves of oil and gas. No gains or losses are recognized upon the sale or disposition of properties except under circumstances which result in major disposals of reserves.

Other properties and equipment —

Mill buildings and related equipment as well as the cost of the preconcentrator (included in deferred costs), less estimated salvage value, are being depreciated and amortized over the estimated life of a copper ore body to December, 1974.

Buildings, service rigs and related equipment and rental equipment are depreciated over the estimated useful lives of such assets using the straight-line method, except for other equipment which is depreciated by the declining balance method.

Depreciation rates are as follows:

	Rate per annum
Buildings	3 –12½ %
Service rigs and related equipment	6⅔ %
Rental equipment	6⅔–20 %
Other equipment including automobiles, furniture and fixtures	20 –30 %

Deferred costs —

Mining claims and related deferred exploration costs for all properties on which the Company does not intend to carry out further exploration, have been written off.

Income taxes —

It is the policy of the Company and its subsidiaries to charge earnings with income taxes currently payable and with income taxes deferred by claiming certain costs and expenses (mainly exploration and development costs and depreciation) for tax purposes before they are recorded in the accounts as a charge against operations. The accumulated total of such income tax deferments is shown in the consolidated balance sheet as "Deferred income taxes".

Interest on the income debenture, goodwill amortization and other charges, that are not deductible for tax purposes, result in increased tax provisions for accounting purposes. Conversely, depletion with respect to oil and gas profits, results in an assumed effective tax rate of approximately 35% on such profits and therefore reduces tax provisions for accounting purposes.

Income per common share —

Income per common share has been calculated in accordance with Canadian practice by dividing the income by the weighted average number of common shares outstanding during each year. No material dilution of earnings per share would result assuming conversion of the income debenture and exercise of outstanding options. Income per share, calculated in accordance with United States practice is not materially different.

Extraordinary items —

The companies follow Canadian practice with respect to the definition of extraordinary items. The extraordinary items, shown in the statement of operations, would be considered ordinary items under United States practice and income per common share before extraordinary items would not be applicable.

2. Changes in components of working capital:

Increase (decrease) in current assets —	1974	1973
Cash	$1,442,000	$ 53,000
Accounts receivable	759,000	(37,000)
Inventories	57,000	80,000
Other	6,000	5,000
	2,264,000	101,000
Less: Decrease (increase) in current liabilities —		
Bank demand loans and indebtedness	913,000	(169,000)
Accounts payable and accrued liabilities	(443,000)	(486,000)
Current portion of long-term debt	24,000	(317,000)
	494,000	(972,000)
Increase (decrease) in working capital	$2,758,000	$ (871,000)

3. Accounts receivable:

Accounts receivable includes unbilled costs of $4,000 ($110,000 — June 30, 1973) and a total amount, owing from an officer at June 30, 1974, of $54,000 (1973 — $35,000 from a director and from an officer).

4. Inventories:

	1974	1973
Oil and gas equipment for resale	$ 317,000	$ 267,000
Mill supplies	93,000	86,000
	$ 410,000	$ 353,000

5. Advances to drilling fund programs:

As outlined in Note 1, advances to drilling fund programs are considered to be eliminated on allocation of bank loans so obtained.

	1974	1973
Amounts charged to drilling fund programs	$1,251,000	$1,201,000
Bank loans allocated	1,147,000	1,185,000
Advances to drilling fund programs	$ 104,000	$ 16,000

6. Investments:

(a) Companies for which there is a quoted market value —

	1974		
	Original cost	Carried value	Quoted market value
Shares of:			
Magnetics International Ltd.	$ 622,000	$ 322,000	$ 296,000
New Hosco Mines Ltd.	523,000	202,000	110,000
Other	268,000	80,000	207,000
	$1,413,000	$ 604,000	$ 613,000

In the opinion of management, the excess of carried value over quoted market value for Magnetics and New Hosco, does not represent a permanent diminution in value of these investments at June 30, 1974.

(b) Investments in affiliated companies —

	1974	1973
Shares, at cost plus equity in undistributed net income since acquisition	$ 99,000	$ 72,000
Deferred gain on sale of equipment	(23,000)	(14,000)
Interest bearing advances	192,000	211,000
	$ 268,000	$ 269,000

7. Properties and equipment:

Cost:	1974	1973
Land and buildings	$ 831,000	$ 879,000
Petroleum and natural gas properties	8,618,000	7,577,000
Service rigs and related equipment	4,632,000	4,045,000
Mill buildings and related equipment (i)	1,320,000	1,320,000
Rental equipment	902,000	777,000
Other equipment	596,000	488,000
	$16,899,000	$15,086,000
Accumulated depreciation and depletion:		
Buildings	$ 331,000	$ 352,000
Petroleum and natural gas properties	814,000	419,000
Service rigs and related equipment	1,958,000	1,693,000
Mill buildings and related equipment (i)	1,051,000	1,003,000
Rental equipment	141,000	91,000
Other equipment	287,000	210,000
	$4,582.000	$3,768,000

(i) These assets are located on property leased at an annual rental of $1 under an agreement extending for a period of seven years commencing upon the termination of a joint venture agreement presently anticipated to expire in December, 1974.

8. Deferred costs:

	1974	1973
Deferred exploration costs (Perch River, Quebec) (i)	$ 356,000	$ 245,000
Joint venture preconcentrator-share of cost less amortization	42,000	106,000
	$ 398,000	$ 351,000

(i) Work to date has not established a proven ore reserve; the Company does, however, intend to carry out further exploration.

9. Bank demand loans and indebtedness:

Bank demand loans and indebtedness are secured by a general assignment of accounts receivable of subsidiaries.

10. Long term debt:

	1974	1973
Secured Convertible Income Debenture, interest at 6½%, due October 31, 1989, repayable in annual instalments of $400,000 commencing on October 31, 1980; convertible into common shares at $6 per share to February 28, 1979 and $7 per share thereafter to February 28, 1984; secured by a first floating charge on all of the property and assets of the Company subject to specific permitted encumbrances and a pledge of the shares of the subsidiaries of the Company	$4,000,000	$ —
Bank loans, (Section 82) interest at ½ to ¾ of 1% over the Canadian prime rate, evidenced by demand notes, secured by a general assignment of the companies' interest in petroleum and natural gas properties, together with specific assignment of production therefrom, repayable monthly, to mature in 1977-1978	2,896,000	3,986,000
Term bank loans, interest at 1¾% over the Canadian prime rate, secured by a first mortgage on certain equipment and a floating charge debenture, repayable monthly up to 1977	964,000	1,152,000
Other loans and mortgages, interest at 0 to 13%, secured by specific properties or assignments, due on various dates to 1984	164,000	232,000
	8,024,000	5,370,000
Less: Current portion of long term debt	1,197,000	1,221,000
	$6,827,000	$4,149,000

Principal repayments over the next five years are as follows:

1975	1,197,000
1976	1,195,000
1977	1,122,000
1978	546,000
1979	73,000

11. Contingent liabilities and commitments:

(a) Legal actions —
On November 19, 1972 a suit was filed, in the United States, by an investor in Provident Oil and Gas Year End Program 1970 claiming $60,000 plus interest to date or an unspecified amount of damages. Answers have been filed denying the claim and, in the opinion of management, the claim is unfounded.

Other legal actions outstanding at June 30, 1973 have been settled and the fiscal 1974 statement of operations includes direct costs with respect thereto amounting to approximately $10,000.

(b) Bank loans —
To the extent that bank loans referred to in Note 5, are not repaid from the proceeds of production from, or sale of, program properties, Provident would be directly liable.

A subsidiary has guaranteed bank loans of affiliated companies, which, at June 30, 1974, amounted to $246,000.

(c) The companies have commitments in the normal course of business, including Provident Resources Ltd. agreements to manage the drilling fund programs and the commitment outlined in Note 16.

12. Capital stock:

During fiscal 1974, an additional 6,000,000 common shares of no par value were authorized. 666,667 shares are reserved, see Note 10 — Income Debenture.

At June 30, 1974, 124,500 common shares were reserved for issuance under an Incentive Stock Option Plan. Options have been granted to employees and officers to purchase 112,450 and are exercisable cumulatively in five equal annual instalments to May, 1979. The directors have approved a purchase price for such options of $5 per share.

13. Consolidated retained earnings:

	1974	1973
Retained earnings (deficit), beginning of year	$ 200,000	$ (197,000)
Less:		
Adjustment to carrying value of investments	—	85,000
Reassessment of fiscal 1968 Quebec mining taxes	—	20,000
	—	105,000
As restated	200,000	(302,000)
Net income for the year	388,000	502,000
Retained earnings, end of year	$ 588,000	$ 200,000

14. Remuneration of directors and officers:

The Company has eight directors who received fees of $16,200 ($11,200 in 1973) and six officers, five of whom are also directors, who received remuneration of $247,025 ($193,812 in 1973) in their capacity as officers.

15. Income taxes — Canadian Merrill Ltd.:

The Company and each of its subsidiaries file separate tax returns. Income tax provisions and deferred income taxes, recorded in the consolidated financial statements, relate solely to subsidiaries.

No provision for income taxes is required in the accounts of Canadian Merrill Ltd. (as a corporation) because its operations, to date, have resulted in accounting losses. On a cumulative basis, its costs and expenses charged to operations exceed the corresponding amounts claimable for tax purposes by approximately $3,900,000 (1973 — $3,950,000 cumulatively of which approximately $100,000 arose during fiscal 1973). No recognition has been given in the accounts for possible future tax benefits related thereto. At June 30, 1974, assuming tax depletion and a resulting effective tax rate of 33⅓%, such benefits would amount to approximately $1,300,000 or assuming no tax depletion and a resulting effective tax rate of 50% such benefits would amount to $1,950,000. Since the realization of these possible future tax benefits is not virtually assured they have not been recorded in the accounts.

16. Peru exploration agreements:

The Company is party to agreements which provide, basically, that —

Upon receipt of a satisfactory assignment of a 12½% undivided interest in a contract providing for the exploration and development of a specific area in Peru from the operator, Oceanic Exploration Company, the Company will be committed to incur development expenditures of a minimum of approximately $1,400,000 U.S. This assignment is subject to the prior approval of the Government of Peru.

To June 30, 1974, invoices totalling $662,500 U.S. have been received, however, approval has not yet been obtained and a satisfactory assignment of the interest has not yet been received. Accordingly, these invoices were not paid at June 30, 1974 or recorded in the accompanying consolidated financial statements.

Subsequent to June 30, 1974, the Company paid $662,500 of which $331,250 has been placed in a special escrow account pending approval by the Government of Peru of the assignment; the balance of $331,250 has been paid to the operator and is secured by an irrevocable letter of credit drawn in favour of the Company by Oceanic Exploration Company that may be presented should an approved assignment not be received. As invoices (cash calls) are received, further payments, under the same conditions, will continue to be made.

Auditors' Report

To the Shareholders of
Canadian Merrill Ltd.

We have examined the consolidated balance sheet of Canadian Merrill Ltd. and its subsidiaries as at June 30, 1974, and consolidated statements of operations and changes in financial position for the year then ended, and have obtained all the information and explanations we have required. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion and according to the best of our information and the explanations given to us and as shown by the books of the companies, these consolidated financial statements are properly drawn up so as to exhibit a true and correct view of the state of the affairs of the companies as at June 30, 1974, and the results of their operations and the changes in their financial positions for the year then ended, in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Calgary, Canada,
September 12, 1974

PRICE WATERHOUSE & CO.,
Chartered Accountants.

Canadian Merrill Ltd.

Principal Operating Subsidiaries of Canadian Merrill Ltd.
Baldwin & Knoll Limited
L & M Oilfield Equipment Ltd.
Provident Resources Ltd.

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Stock Exchange Listings
Toronto Stock Exchange
Toronto, Ontario

Montreal Stock Exchange
Montreal, Quebec

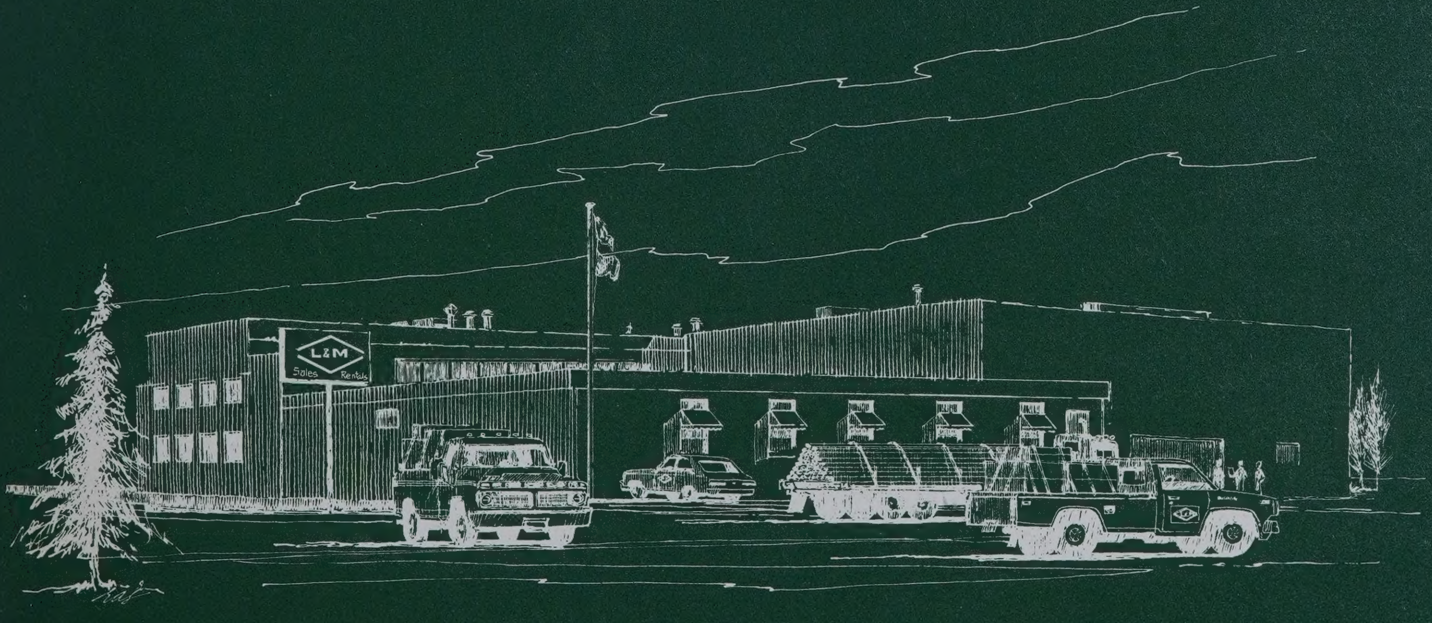
American Stock Exchange
New York, New York

Transfer Agents & Registrar
The Canada Permanent Trust Company
Montreal, Quebec
Toronto, Ontario
Calgary, Alberta

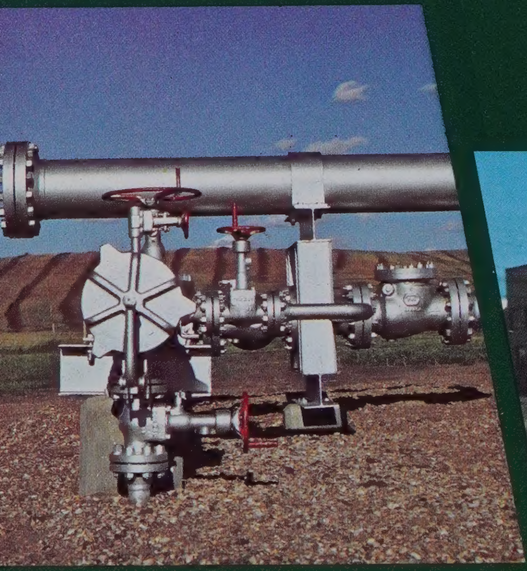
The Canadian Bank of Commerce Trust Company
New York, New York

Auditors
Price Waterhouse & Co.
Chartered Accountants
Calgary, Alberta

Bankers
The Royal Bank of Canada
Calgary, Alberta



Canadian Merrill Ltd.



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